

COPY

MEMORANDUM OF UNDERSTANDING

No. 2000-001-274

AGREEMENT BETWEEN:

UTAH ATTORNEY GENERAL

December 18, 2000

ALLIED WASTE INDUSTRIES, INC.

I. BACKGROUND

Allied Waste Industries, Inc. (Allied) is in the business of providing commercial waste [defined as one to ten cubic yard small container commercial waste in Washington County, Utah] collection and disposal services in numerous markets throughout the United States. Allied's operations in Washington County, Utah are conducted through a subsidiary, Allied Waste Transportation, Inc. -- which conducts business in Utah under the name Red Rock Waste.

Pursuant to a November 1998 agreement, Allied sought to acquire waste collection and disposal assets of Browning-Ferris Industries, Inc. (BFI), including BFI assets in Washington County, Utah. The merger would combine the largest and third largest firms serving Washington County and St. George, Utah, resulting in Allied servicing what the Attorney General believed was 76% of the commercial waste collection.

The Utah Attorney General conducted an investigation during 1999 into the competitive effects of this merger. This analysis examined not only the effects of the merger on the commercial waste hauling operations of the two companies, but also the effects on the merger of Allied's separate operational control over the Washington County landfill and its possession of an exclusive contract for collection of residential waste in the county. In the end, the Attorney General agreed to permit the merger to proceed on Allied's acceptance of certain conditions.

On April 27, 1999, the Utah Attorney General filed suit against Allied, seeking court approval of a negotiated consent decree containing terms under which the State of Utah would not contest consummation of the merger. A "Final Judgment" implementing the consent decree was entered by the U.S. district court on June 29, 1999. *State v. Allied Waste Industries*, No. 2:99-CV-00303J (D. Utah Jun. 29, 1999).

II. FINAL JUDGMENT

The Final Judgment contained conditions designed to prevent Allied from using its size, operational control of the landfill, or residential waste collection contract to obtain any unfair advantages over smaller commercial waste haulers competing against Allied in Washington County. Among other restrictions, Allied was precluded from selling its commercial waste collection services at prices below its fully-allocated average cost.

So long as Allied has more than 60% of the commercial small container waste hauling market in Washington County, Utah, it will not provide any commercial waste hauling services at a price below its fully-allocated cost of providing those services. It is not permitted to meet a price offered by a competitor if that price is below Allied's own fully-allocated cost of providing the service. . . .

Final Judgment ¶VII.

This restriction was especially targeted at preventing Allied from using its financial strength to set prices below its fully-allocated average cost in a manner that would cause the

remaining four competitors to be unable economically to compete for this type of business.

Because the Attorney General believed that three of the four remaining competitors had less than 5% market share each, the Attorney General was concerned they were at special risk of competitive harm from any pricing by Allied that was below its own fully-allocated average cost.

III. INQUIRY INTO ALLEGATIONS OF BELOW FULLY-ALLOCATED AVERAGE COST SALES

On March 27, 2000, Allied entered into a small container commercial waste hauling contract for a private company in St. George at a price of \$1.50 per yard. This price was based on the fact the customer had multiple containers at one location, wanted daily collection of the containers and the customer's waste was mainly lightweight paper, plastic and cardboard. On April 19, 2000 Allied also submitted a bid to the City of St. George for solid waste pickup and disposal. That bid proposed a collection fee of \$1.50 per yard of waste and was based on the fact that the customer had thirty containers, some located at a single location and all located close to one another. Allied did not win this bid.

The Attorney General was made aware of these two service offers and, on May 5, 2000, requested that Allied provide information showing its fully-allocated average cost of providing commercial waste collection services in Washington County. This inquiry sought to determine whether the \$1.50 per yard price offered to these two customers was below Allied's fully-allocated average cost of providing those services. By letter dated June 6, 2000, Allied responded to the Attorney General.

A. Allied's Response

The information provided to the Attorney General in June, 2000 by Allied was incomplete and inaccurate and therefore potentially misleading. The information claimed a fully-allocated average cost for Allied's operations in Washington County of \$1.41. The

information provided by Allied omitted significant costs that should have been factored into the fully-allocated average cost analysis and used sample data that implied lower fully-allocated average costs than actually existed.

B. The Attorney General's Analysis

After analyzing the information supplied by Allied, the Attorney General opened a full investigation into the pricing practices of Allied. This investigation focused on whether Allied a) had engaged in pricing below its fully-allocated average cost, b) was in violation of the Final Judgment, and c) provided false and misleading information to the Attorney General in connection with the inquiry. By letter dated August 4, 2000, the Attorney General informed Allied of the inadequacy of the information provided and requested substantial additional financial and operational information about the company.

C. Actions Taken by Allied in Response to the Investigation

After receiving the Attorney General's August 4 letter and analysis, Allied undertook a number of significant steps to prevent a continuation of the conduct which the Attorney General deemed inconsistent with the terms of the Final Judgment. Allied reviewed Red Rock's financial statements to determine whether these statements were being reported in accordance with generally accepted accounting principles. After identifying certain accounting inaccuracies, such as failures to properly allocate certain district costs to Red Rock as well as certain costs that were internally misallocated as between Red Rock's different lines of business, Allied provided the Attorney General with revised financial figures which it later incorporated into the route audit.

At a meeting with the Attorney General's office on September 7, 2000, Allied's attorneys and its District Controller informed the Attorney General's office of the results of the preliminary analysis of Red Rock Waste's financial records. In addition, Allied provided information requested by the Attorney General's August 4 letter. This included:

- The expected starting and ending dates for the route audit.
- Copies of financial reports for Red Rock Waste's actual operations for the prior six quarters.
- Information identifying the routes used by Red Rock for waste collection and showing the volume of commercial waste collected on each route.
- Internal financial documents used to estimate income, expenses, and profitability for each of Red Rock's lines of business.
- An explanation of how general operational costs of Red Rock were allocated to the commercial waste collection operations and a summary of the accounting mistakes identified by Allied's accounting staff relating to inaccurate allocation procedures.
- Depreciation schedules which describe the assets, the original cost and the accumulated depreciation of the assets.
- An explanation of the allocation of expenses among various business lines of Red Rock, including commercial waste collection.

Effective September 8, 2000, Allied instructed Red Rock to cease bidding or offering commercial waste hauling services at a price of less than \$2 per yard (until its true fully-allocated average cost could be determined). Allied's Southwest Region Office also commissioned a "route audit" to determine the actual fully-allocated average cost of providing commercial waste collection services in Washington County, Utah.

In preparing the information that was furnished to the Attorney General in September, Allied's accountants identified erroneous accounting practices in use by Red Rock. Allied implemented proper accounting practices at Red Rock so that all future financial statements will

accurately allocate all company-wide costs. Allied also provided the Attorney General with restated financial information for Red Rock -- adjusted to account for the inaccurate accounting practices previously utilized by Red Rock. Those adjustments revealed that the fully-allocated average cost for Red Rock's commercial waste collection operations was higher than had been reflected on internal accounting records maintained by Red Rock (before consideration of the then-pending route audits).

D. Route Audit

Allied began the route audit in September and completed the audit in October 2000. The results of the route audit revealed an overall fully-allocated average cost for commercial waste collection within the St. George area that was substantially higher than the \$1.50 prices leading to this investigation. In addition, the cost of servicing the particular customer receiving services at \$1.50 per yard were revealed to be higher than the prices actually charged to that customer (even taking into account efficiencies resulting from the customer having multiple containers at the same location).

E. Corrected Information Provided to the Attorney General's Office

After determining its actual fully-allocated average cost of providing small container commercial hauling services, Allied conducted a manual audit of existing service agreements to determine which customers were being charged less than this revised fully-allocated average cost per yard. In a November 17, 2000 meeting with the Attorney General's office, Allied explained the results of the route audit and provided information on these customers. Allied explained its belief that each of these service agreements individually was profitable, in that each recovered costs in excess of Red Rock's marginal costs, but recognized that some of the service agreements were priced at less than Red Rock's average total fully-allocated average cost.

The information provided by Allied at the September and November meetings was complete, accurate, and fairly presented. The Attorney General's office is satisfied that the source of the problems with the accounting procedures used by Red Rock have been identified and corrected. Moreover, the Attorney General's office is satisfied that Allied has now taken adequate steps to prevent a recurrence of problems that had led to the investigation into below fully-allocated average cost sales.

IV. PUNITIVE SANCTIONS

As noted above, the Attorney General now is satisfied that the information provided in September through November is accurate and that Allied has taken proper steps to ensure that no further violations of the Final Judgment will occur. Nevertheless, The Attorney General's office has concluded that after entry of the Final Judgment, Red Rock - while holding a high market share of the commercial waste collection business in St. George - did a) sell and bid its services at prices below its total fully-allocated average cost, b) violate certain terms of the Final Judgment, and c) provide inaccurate and therefore potentially misleading information to the Attorney General as part of the State's investigation into this matter.

Allied understands the concerns underlying the State's investigation and acknowledges the inadequacy of Red Rock's efforts to consistently maintain all small container commercial service prices at above its fully-allocated average cost as well as the insufficiency of its initial response to the State's inquiry. In an effort to satisfy the State's concerns and avoid the necessity of court filings or litigation to determine whether Allied violated the Final Judgment, Allied hereby agrees that it has taken or will take the following actions and hereby consents to the remedies described below:

1. Allied has installed a site manager at Red Rock who is responsible for overseeing compliance with the Final Judgment, implementing fiscal and accounting changes

necessary to proper allocation of costs, and ensuring that future commercial waste hauling services will be priced properly.

2. Route audits will be conducted periodically to determine Red Rock's actual fully-allocated average cost of serving commercial waste customers and that actual fully-allocated average cost will be used as a basis for future adjustments of pricing - consistent with requirements of the Final Judgment.
3. Changes to Red Rock's accounting and financial systems have been implemented to record accurately the company's fully-allocated average cost of operation and to allocate properly to the commercial waste collection line of business the proportional costs of management, operational, and administrative expenses.
4. As a result of the deficiencies identified in this investigation, Allied has conducted a thorough review of consent decrees affecting other Allied operations across the country to identify actions that need to be taken to make sure the requirements of those consent decrees are satisfied. A new system is now in place to enhance Allied's compliance with requirements of these other consent decrees.
5. Allied has implemented a program of antitrust compliance training for Red Rock management and employees.
6. For any of Red Rock's current commercial waste customers whose accounts are being serviced at a price less than Red Rock's fully-allocated average cost for that type of service, Red Rock will increase prices to those customers to a level higher than its fully-allocated average cost. In some cases, these prices cannot be raised until the end of contracted periods of time.

7. Services for new customers will be priced at levels consistent with the requirements of the Final Judgment.
8. Within ten days of the date of this agreement, Allied will forward to the Attorney General a payment, in lieu of a fine, in the amount of \$110,000 -- representing approximately one twelfth of Red Rock's annual net income for 1999. This payment reflects not only compensation for the time and effort of the Attorney General in conducting this investigation, but also serves as a sanction for Allied's conduct in pricing below its fully-allocated average cost, failing to ensure complete compliance with all of the terms of the Final Judgment, and submitting inaccurate or incomplete information in response to the Attorney General's informal information requests.
9. Allied represents that the information provided to the Attorney General regarding Red Rock's fully-allocated average cost is accurate and complete. Based on this representation, the Attorney General represents that this agreement resolves any and all of the Attorney General's concerns regarding compliance by Allied and/or Red Rock with the provisions of the Final Judgment relating to pricing below fully-allocated average cost for the period beginning with the entry of the Final Judgment and ending on the date of execution of this agreement. If the Attorney General determines that Allied has, by any action or inaction taken after the date of this agreement, failed to comply with its obligations under this agreement or has

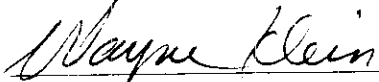
engaged in any conduct in violation of the Final Judgment, and initiates civil action to enforce the Final Judgment or this agreement, the Attorney General can submit evidence described in this agreement as evidence of Allied's failure to comply.

10. This agreement is between Allied and the Attorney General and does not create any rights or interests in any other parties.
11. This agreement is a public record.

V. EXECUTION

DONE this 18th day of December, 2000.

STATE OF UTAH



WAYNE KLEIN

Assistant Attorney General
Inc.

ALLIED WASTE INDUSTRIES, INC.



DONALD W. SLAGER

VP, Operations for Allied Waste Industries.

Scottsdale, AZ



TOM D. SMITH

Jones, Day, Reavis & Pogue
Washington, D.C.

Counsel for Allied Waste Industries, Inc.